AIFM Directive and the impact in Switzerland

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AIFMD – What does it mean for Swiss managers?

Sandrine Leclercq
AIFMD what is it all about?

First regulation in the EU for entities managing AIFs

Regulates management & marketing of AIFs

- Covers all types of AIF not qualifying as UCITS (regulated or not)
- Need to appoint one single manager ("AIFM")
- Level playing field allowing for (i) passport for AIFM and (ii) distribution of AIFs within the EU
- Revamp of Depositary regime

Does not regulate passive marketing of AIF

Transition regime
All Collective investment undertakings
• which raise capital
• from a number of investors (individuals or professionals)
• with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and
• which is not a UCITS

Legal person
• whose regular business is managing one or more AIFs, located in the EU or abroad
• has at least in its functions both risk management and portfolio management
• can be the AIF itself (Self-managed AIF)
Extraterritorial reach

- EU AIF with EU manager → in scope
- EU AIF with non EU manager → in scope
- Non EU AIF with EU manager → in scope
- Non EU AIF with non EU manager → in scope if “marketed” in the EU
Grandfathering clause

- AIFM of closed-ended AIF which subscription period is closed by 21 July 2011 and whose duration expires by 23 July 2016
- AIFM of closed-ended AIF which does not invest any longer after 22 July 2011

ESMA draft RTS on the definition of closed-ended funds

⇒ the AIFM can continue to manage the AIF without complying with AIFMD (except for annual report / transparency requirements)
Below threshold (EU) AIFM may go for lighter regime until 2018

AIFM with leveraged AuM < 100 Mio
AIFM with non leveraged AuM < 500 Mio (closed-ended AIF)

AIFM Level II on calculation of AuM of small AIFM
- calculation of the AuM
- definition of leverage

⇒ Limited obligation of registration, information and notification to supervisory authority
⇒ “Opt-in” possibilities to get the distribution passport
⇒ No right granted by the Directive available to them
Small AIFM -
Determination of the threshold

<table>
<thead>
<tr>
<th>Asset Under Management</th>
<th>Leverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>❖ procedure and methodology to calculate AuM</td>
<td>❖ defined as the ratio between exposure and NAV</td>
</tr>
<tr>
<td>❖ annual calculation and ongoing monitoring of the AuM</td>
<td>❖ 2 methods to calculate leverage</td>
</tr>
<tr>
<td>❖ action to be taken when exceeding thresholds</td>
<td>❖ gross method</td>
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<tr>
<td>❖ right of the authority to check the correctness of the calculation</td>
<td>❖ comittment method</td>
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<td>❖ calculation methods documented</td>
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<td>❖ temporary and covered borrowings excluded from the leverage calculation</td>
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Complying with AIFMD - The stakes
The stakes of a full compliance with AIFMD

<table>
<thead>
<tr>
<th>Direct Regulation of the EU AIFM</th>
</tr>
</thead>
<tbody>
<tr>
<td>The AIFM must be <strong>authorised</strong></td>
</tr>
<tr>
<td>The AIFM must comply with <strong>capital, organisational, and business conduct requirements</strong>:</td>
</tr>
<tr>
<td>Capital/insurance</td>
</tr>
<tr>
<td>Technical and human substance</td>
</tr>
<tr>
<td>Risk management</td>
</tr>
<tr>
<td>Independent valuation</td>
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<th>Passport of the AIFM for management and distribution</th>
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<tr>
<td>Once an AIFM is <strong>authorised</strong> in one member state and complies with the AIFMD, it will be entitled upon <strong>notification, to manage and/or market AIFs to professional investors</strong> throughout the EU without requesting any local authorisation</td>
</tr>
<tr>
<td>Passport for EU AIFM with EU AIF available from 2013 and for other AIFMs from 2015</td>
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<tr>
<td>NPPR for non exclusively EU set-ups may be authorized until 2018</td>
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<th>Indirect Regulation of the AIF</th>
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<td>The AIFM must comply with <strong>specific rules related to the AIF</strong></td>
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<tr>
<td>Liquidity management</td>
</tr>
<tr>
<td>Transparency</td>
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Delegating the Investment Management

- Delegation cannot be used to circumvent the rules
- Delegation to a regulated entity in third country only if cooperation agreement in place
- Letter box prohibition

AIFM looses its status if:
- No longer expertise remained in AIFM
- No longer power to take decision
- Loss of supervising power over the delegates
- Delegates the performance of investment management functions to an extent that exceeds by a substantial margin the investment management functions performed by the AIFM itself
Impact on distribution in the EU
From National Private Placement Regime to the Passport

Local PPR will no longer exist after 2018 (the latest)

Notification regime- mandatory after 2018
Scaled approach for non EU AIFMs/AIFs

- AIFM Directive rules **all types of** “marketing” as **any** direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares in an AIF it manages to or with investors domiciled or with a registered office in the EU

- Exclusion of so called “reverse solicitation” or “passive marketing” practices - no harmonized definition

- **2013** - Minimum requirements for a **third country manager** to continue to market its AIF in the EU under the PPR (where available)
  - Registration and transparency requirements with Member States of distribution
  - Check minimal cooperation agreements and FATF compliance

- **2015** - First time to benefit from the passport
  - Subject to **full equivalence of AIFM** and enhanced cooperation regime with relevant third countries

- **2018** - Mandatory compliance and end of local regimes.
EU Passport- what does it bring?

Once approved according to AIFM criteria, you will be able to:

- Advertise and distribute actively and publically your AIF throughout the wider EU to professional investors without requesting a country by country authorisation

- Manage AIFs based in the EU (either directly or through establishing a branch)
How do I get the passport?

- **EU AIFM**
  - Notification process through home country
  - 20 days maximum
  - No possibility to refuse other than in case of debated compliance

- **Non EU AIFM**
  - Registration with the MS of Reference responsible for assessing the equivalence conditions and cooperation rules
  - Notification to other MS through the MS of Reference for management and distribution passport
  - Appoint a legal representative for distribution in the EU
Determining the MS of Reference

**Place of AIF and marketing**

- EU AIF managed by non EU AIFM marketed *only in the MS of the EU AIF*
- EU AIF managed by non EU AIFM marketed *only in another MS of the EU AIF*
- **non-EU AIF** managed by non EU AIFM marketed *in one MS of the EU*
- non-EU AIF managed by non EU AIFM marketed *in several MS of the EU*
- **several EU AIF from the same MS** managed by non EU AIFM marketed *in several MS of the EU*
- **several EU AIF from different MS** managed by non EU AIFM marketed in several MS of the EU
- **several non-EU AIF and EU AIF** managed by non EU AIFM marketed in several MS of the EU

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**MSR**

- MS of the EU AIF
- MS of the marketing
- **any** of the MS (to be jointly agreed between any of MS)
- MS of the EU AIFs or MS of effective marketing for most of those AIFs
- MS of effective marketing for most of those AIFs
Available operating schemes for Swiss managers?
Business continuity for licenced Swiss manager with Lux AIF until 2015? (no passport)

Cooperation agreement is given
No further AIFM D requirement
As from 2015 Swiss AIFM based on full equivalence - Passport

Lux Sicav

Swiss Full AIFM

Delegated licenced manager

Equivalence assessed by MS of Reference based on ESMA

Limitations on the amount of tasks delegated
Business continuity for licenced Swiss manager with below threshold Lux AIF until 2018 (no passport)

- Lux Sicav as below threshold self AIFM
- Swiss licenced delegated investment manager

No AIFM requirement applies
No limit on amount of delegated tasks
Lux AIF with EU AIFM delegating back to Swiss manager - passport as from now

Limitation on the amount of tasks delegated
How do I build my AIFM in Luxembourg?

- Luxembourg available models to support local substance
- UCITS/AIFM “Supermancos”
- Extent of the delegation: emerging models with RMP in Luxembourg and Investment management in Switzerland
- Additional conditions imposed by Finma?
New regulatory environment for asset managers of collective investment schemes – an evolution

Theodor Härtsch
Relevance of AIFMD for Swiss asset managers

- Swiss asset manager manages AIF domiciled in the European Economic Area
- Swiss asset manager markets AIF to professional investors in European Economic Area
- AIFM (with domicile in the European Economic Area) delegates portfolio management and/or risk management to Swiss asset manager
- Need to obtain – as a matter of fact – an authorization as asset manager of collective investment schemes
Are timelines compatible?

National private placement regimes of European Economic Area member states continue to apply

22 July 2013  Mid 2015  2018

Revised CISA enters into force

1 March 2013  1 Sept 2013  1 March 2015  2018

Notification obligation

Transitory period of 2 years

EEA passport for Swiss AIFM can be obtained

Window of opportunity of approximately 3 years to obtain an EEA passport

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Key changes (I)

- Mandatory licensing of investment managers if they manage assets of
  - Swiss collective investment schemes
  - Foreign collective investment schemes in or from Switzerland
- De minimis-exemptions
  - Master Funds with assets under management ≤ CHF 100 million (including leverage)
  - Feeder Funds with assets under management ≤ CHF 500 million (portfolio consisting of non-leveraged master funds)
  - Apply only in case of asset management for foreign collective investment schemes
Key changes (II)

- Possibility to opt-in (voluntary licensing for asset managers of (foreign) collective investment schemes)
- Exemptions from the licensing obligation in case of equivalent prudential supervision if
  - Objectives of the law are not impaired
  - Only certain licensed financial institutions/persons delegate asset management
Permissible tasks of asset managers

- Portfolio management
- Risk management
- Other services
  - Fund business for foreign collective investment schemes
  - Individual investment management for customers (classical investment management on a mandate basis)
  - Investment advisory
  - Distribution of collective investment schemes
  - Representation of foreign collective investment schemes
Personal requirements

- Permissible legal forms
  - Legal entities
  - Partnerships and limited partnerships
  - Swiss branches of foreign asset managers of collective investment schemes

- Prohibited legal forms
  - Natural persons
  - Individual firms
General authorisation requirements

- Sufficiently qualified personnel
- Requirements as to the board of directors and the executive management
  - Good reputation
  - Guarantee for a proper business conduct
  - Required (sufficient) qualifications
- Requirements as to qualified participants (holding more than 10% of the share capital and/or voting rights)
  - Good reputation
  - Influence may not be to the detriment of a proper business conduct
Financial requirements

- Minimum capital
  - CHF 200'000
  - Exception for the fund management for foreign collective investment schemes: CHF 500'000
  - Partnerships: possibility of a guarantee or similar security

- Capital maintenance rules
  - ¼ of the expenses according to the last profit and loss statements
  - 0.02% of the assets under management in excess of CHF 250 million
  - Cap at CHF 20 million

- Additional capital maintenance requirement of 0.01% of assets under management in case there is no professional liability insurance
Organisational requirements

- Separation of investment decision, implementation and administration (control in the area of the investment management)
- Board of directors
  - At least three members
  - Majority must be non-executive
  - One third must be independent from qualified participants
- Clear separation of the roles of the chairman of the board of directors and the CEO
- Management
  - At least two members
  - Residence at a place where they can effectively carry out the management of the company
Organisational model

Board of directors
1  2  3

Management
1  2

- Risk management
- Internal controls
- Compliance

(Investment) decision
Implementation
Administration (control)

Non-executive
Independent from qualified participants
Organisational requirements

- Articles of incorporation and organisational regulations
  - Description of the scope of activities/description of geographic scope
  - Description of the entire organisation and business activities
  - Approval of FINMA required
- Internal rules and regulations (“directives”)
  - Directive risk management
  - Directive conflicts of interests
  - Directive compliance
  - Directive prevention of money laundering and financing of terrorism
  - Directive internal controls
  - Directives need to be adjusted to the organisation of the asset manager
Application

- FINMA template application
- Swiss official language (German, French, Italian)
- Important points
  - Reasons for application
  - Scope of activities
  - Investment decision process
  - Internal organisation
  - Implementation within a group of companies
Distribution in Switzerland - what has changed?

Theodor Härtsch
"Distribution" as relevant criterion I

- "Distribution" means any offering and any marketing of collective investment schemes ("CIS"), including AIFs
- No longer relevant whether or not such offering or marketing qualifies as "public"
- The term "distribution" is further specified in the FINMA-Circular 2013/9 – “Distribution of Collective Investment Schemes”
  - Published on 28 August 2013
  - Entry into legal force on 1 October 2013
"Distribution" as relevant criterion II

- Exceptions
  - Offering or marketing of CIS to banks, securities dealers, fund managers or insurance companies
  - Offering or marketing from Switzerland of foreign CIS to qualified investors only
  - Providing information about CIS and acquisition of CIS upon request of an investor
    - reverse solicitation
    - execution only
"Distribution" as relevant criterion III

- Exceptions (continued)
  - Providing information about collective investment scheme or acquisition of interests/shares under written asset management agreement with
    - Bank or securities dealer
    - Subject to certain conditions – with an independent asset manager
  - Publication of prices, NAVs or tax data by supervised financial intermediaries (without provision of contact details)
Qualified investors

- Banks
- Securities dealers
- Fund management companies
- Asset managers of collective investment schemes
- Central banks
- Regulated insurance companies

No distribution
Qualified investors

- Public entities
- Pension schemes with professional treasury function
- Companies with professional treasury function
- High net worth individuals that have opted in
  - Assets in the amount of CHF 5 mio
  - Assets in the amount of CHF 0.5 mio in combination with professional expertise

Distribution
Distribution imposes additional obligations

- Distributor must comply with licensing requirements set out in art. 19 para. 1\textsuperscript{bis} CISA and art. 30a CISO
- Distributor must take records
  - Investor needs
  - Advice given
- Duty to adjust documents
- Information obligations regarding distribution-related
  - Fees, costs
  - Considerations (\textit{Vertriebsträgerentschädigungen})
Distribution imposes additional obligations

- Duty to appoint a representative
- Duty to appoint a Swiss paying agent
- Distribution agreement governed by Swiss law with Swiss representative of foreign CIS
Distribution triggers a license

- Foreign CIS that are distributed in Switzerland to qualified investors may be distributed only by financial intermediaries who are adequately supervised in Switzerland or at their foreign corporate domicile, and if a representative (Vertreter) in Switzerland has been appointed

- Who qualifies as financial intermediary?
- What does “adequately supervised” mean?
Duty to obtain a license

- Persons already supervised in an equivalent manner may be exempt from requiring a license (e.g. banks, securities dealers or insurance companies do not need a license to distribute CIS)
Opting in of high net worth individuals

- Requirements:
  - Proof of personal education and professional experience or of a comparable experience (i.e. average of 10 trades in comparable financial instruments in each of the 4 preceding quarters) in the financial sector and proof of assets of at least CHF 0.5 mio, or
  - Written confirmation to hold assets of at least CHF 5 mio.
- In any event: written declaration to be treated as qualified investors (“Opting in”)
- Consequence: HNWI is deemed a qualified investor
Opting out of investment management clients

- Clients of asset managers deemed to be qualified investors irrespective of whether they meet the requirements for an "opting-in"

- Duty of financial intermediary to inform the client and to make her/him aware of
  - Risks involved, and
  - Possibility of "Opting-out", i.e. of right to declare in writing not to be treated as qualified investor

- Consequences?
Information about remuneration

- Complete, true, comprehensible and transparent information about any kind of fees or commission or other monetary benefits (and their respective amount) paid to the distributors
- Duty applies to all distributors and their agents
- Objective: Ensure high price transparency and minimizing potential conflicts of interest
- Is separate information for each CIS required?
- Is information limited to a range with maximum amount and calculation method permitted?
Identification of customers needs

- Duty to identify customer needs
- Duty to keep records about the customer needs and each recommendation to invest in a CIS and reason for such recommendation
- Form and specific contents of records to be determined by way of self-regulation (to be approved by FINMA)
- Duty to give the minutes to the customer - when?
- Additional rules of conduct will only enter into legal force on 1 January 2014
Transitional provisions

- Foreign collective investment schemes that are distributed to qualified investors only: ensure compliance with the new law until 28 February 2015

- High net worth individuals that do not meet the requirements of an "opting-in" within 2 years may no longer acquire CIS for qualified investors
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